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PUBLISHED

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

In Re: NORMAN W. SHEARIN, JR.; ANN SHEARIN,*

Debtors.

STEPHEN L. BEAMAN, Trustee,

Plaintiff-Appellee,

v.

NORMAN W. SHEARIN, JR.; ANN SHEARIN,

Defendants-Appellants.

No. 98-2191

Appeal from the United States District Court
for the Eastern District of North Carolina, at Raleigh.
W. Earl Britt, District Judge.
(CA-98-381-BR-5, BK-96-3403-8-L, AP-97-38-8-L)

Argued: April 8, 1999

Decided: August 17, 2000

Before WIDENER and TRAXLER, Circuit Judges,
and BUTZNER, Senior Circuit Judge.

Affirmed by published opinion. Judge Widener wrote the opinion, in which Judge Traxler and Senior Judge Butzner concurred.

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*Mrs. Shearin's name appears in some of the papers as Anne.

COUNSEL

ARGUED: Richard Merryman Stearns, Kinston, North Carolina, for Appellants. Charlene Boykin King, BEAMAN & KING, P.A., Wilson, North Carolina, for Appellee. **ON BRIEF:** Norman W. Shearin, VANDEVENTER BLACK, L.L.P., Kitty Hawk, North Carolina, for Appellants. Stephen L. Beaman, BEAMAN & KING, P.A., Wilson, North Carolina, for Appellee.

OPINION

WIDENER, Circuit Judge:

Defendants-debtors, Norman W. Shearin, Jr. and Ann S. Shearin, his wife, appeal the district court's judgment affirming the bankruptcy court's order in an adversary proceeding entitling Stephen L. Beaman, Trustee, to recover $52,133.64 from the defendants and, in addition, concluding that Shearin's capital account in the amount of $28,844.10 was property of the estate. The $52,133.64 represents the portion of Shearin's year-end distribution that he earned pre-petition at the law firm of Vandeventer, Black, Meredith, and Martin, L.L.P. in his capacity of equity partner. The capital account sum represents the stipulated amount Shearin had contributed to the law firm. We affirm the judgment of the district court.

I.

On July 12, 1996, Norman W. and Ann S. Shearin filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code, and Stephen L. Beaman, the plaintiff in this action, was appointed as Trustee. Shearin was at that time, and continues to be, an attorney and equity partner at the law firm of Vandeventer, Black, Meredith, and Martin, L.L.P. (Vandeventer). The firm is a registered limited liability partnership with offices located in Norfolk, Virginia and Kitty Hawk, North Carolina. A partnership agreement that was executed on January 1, 1996 governs the law firm. In Schedule B attached to his petition for bankruptcy, Shearin listed his interest in the law firm partnership as an asset with a zero dollar current market value and did not claim an exemption for that asset.

The law firm continued to operate as a reconstituted partnership under the same partnership agreement and organizational scheme after Shearin's filing for bankruptcy. Similarly, Shearin continued as an equity partner of the law firm. The law firm did not wind up its affairs or conduct any settlement of accounts. Pursuant to the partnership agreement, for the purposes of receipts, the law firm's fiscal year runs from December 1 to November 30, at the conclusion of which, the Management Committee of the firm calculates the allocation of profits among the equity partners. First, any available distributive net profits are divided into two portions: objective and subjective. Then, each partner is given an objective and subjective valuation. The Management Committee evaluates each partner objectively using the percentage each partner's receipts contributed to total partnership receipts during the current and preceding two fiscal years. The subjective evaluation is based on a variety of factors ranging from client development to other beneficial contributions to the law firm. Each partner's given objective and subjective percentage is then applied to the respective objective and subjective portion of the law firm's distributable net profits.

The parties stipulated that between December 1, 1995 and June 30, 1996, prior to Shearin's petition, his receipts totaled $276,229.00, and his receipts for the entire 1995-96 fiscal year totaled $322,443.00. Based upon these amounts, the bankruptcy court determined that 85.6% of his receipts was attributable to pre-petition work. When Shearin filed his petition, the Management Committee had not yet ascertained the distributable net profits for the fiscal year. In December 1996, however, Shearin did receive as his share of the distributable net profits for the fiscal year from the law firm, one check for $62,494.00. He received another check in the amount of $17,976.58 in January 1997. The bankruptcy court found that Shearin only netted $76,042.75 of the total disbursements, which reflected the adjustments made by the law firm for the repayment of sums advanced to Shearin earlier in the fiscal year. No exception is taken to this figure. Of that sum of $76,042.75, the bankruptcy court, by prorating and attributing variously objective and subjective funds, arrived at the sum of $52,133.64, which was the share of profits of the law firm due to Shearin for his participation in the affairs of the law firm through July 12, 1996, the day of the filing of the petition. To the amount of

this sum there is also no exception taken on appeal. The exception taken is that none of said sum is subject to turnover to the Trustee.

The bankruptcy court also found that Shearin's capital account, with the stipulated value of $28,844.10 on the date of his petition, was property of the estate. According to the partnership agreement, when a non-equity partner is admitted as an equity partner, he is required to make a capital contribution equal to that of the existing partners with the same seniority. Shearin became an equity partner in 1991.

From the time of Shearin's petition to the entry of discharge in November 1996, the Trustee corresponded with the law firm, making inquiries into Shearin's interest in the law firm. The law firm responded by sending a copy of the partnership agreement to the Trustee and by requesting a confidentiality agreement with the Trustee. The law firm did not, however, segregate any of its records or earnings or make any change in the distributions to Shearin due to his bankruptcy petition.

The bankruptcy court determined that a substantial portion of the year-end profits distributed by the law firm in December 1996 were traceable to Shearin's pre-petition work, thereby becoming property of the estate under 11 U.S.C. § 541(a)(1) and (6). The bankruptcy court also concluded that the entire amount in his capital account, $28,844.10, was property of the estate and that the Trustee could seek its recovery by whatever means he deemed appropriate.

We review an appeal from a district court's order affirming an order of the bankruptcy court *de novo*. See *In re Wilson*, 149 F.3d 249, 251 (4th Cir. 1998). We stand in the shoes of the district court as we review the conclusions reached by the bankruptcy court. See *In re Runski*, 102 F.3d 744, 745 (4th Cir. 1996).

II.

The resolution of this case revolves around the nature of the bankrupt estate's interest in Shearin's law firm partnership interest. On July 12, 1996, Shearin's pre-petition partnership interest in the law firm became property of the estate under § 541(a) of the Bankruptcy

Code. 11 U.S.C. § 541(a)(1) and (6) (defining property of a bankrupt estate as "all legal or equitable interests of the debtor in property as of the commencement of the case"); see also *In re Cordova*, 73 F.3d 38, 42 (4th Cir. 1996) (stating that § 541(a)(1) is all-embracing). In considering the status of Shearin's partnership interest, and specifically his right to receive partnership profits and his capital account, both of which stemmed from his pre-petition past, we consider that courts look to state law when determining a debtor's interest in property. *In re Hudgins*, 153 B.R. 441, 443 (Bankr. E.D. Va. 1993). See *Butner v. United States*, 440 U.S. 48, 54 (1979). The timing of the petition is also relevant because § 541(a) of the Bankruptcy Code allows the debtor to accumulate new wealth and make a "fresh start" after the "commencement of the [bankruptcy] case." See *In re Andrews*, 80 F.3d 906, 910 (4th Cir. 1996).[1] Consequently, consideration of Virginia partnership law, (Virginia's Uniform Partnership Act), and the Bankruptcy Code requires that Shearin's property rights on the date of his petition define his interest in the partnership.[2] See Va. Code Ann. §§ 50-24, et seq. (Michie 1950). It is this "'complex and often tortuous interaction between the Bankruptcy Code, state partnership law, and a [ ] partnership agreement' that causes courts consternation." *In re Grablowsky*, 180 B.R. 134, 137 (Bankr. E.D. Va. 1995) (quoting *In re Cutler*, 165 B.R. 275, 276 (Bankr. D. Ariz. 1994)).

A.

Vandeventer's partnership agreement does not contain provisions addressing a partner's personal bankruptcy.[3] Virginia's version of the

[1]11 U.S.C. § 541(a)(6) further includes any "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except as are earnings from services performed by an individual debtor *after the commencement of the case*" as property of the estate. (emphasis added)

[2]This chapter of the Code of Virginia was repealed effective January 1, 2000, however, we believe that the new code sections do not apply to the facts before us. See Va. Code Ann. § 50-73.147 (Michie 1950). We apply the Uniform Partnership Act as adopted in the Code of Virginia, § 50-1 through § 50-43.12.

[3]The bankruptcy court noted that where the partnership agreement is silent, Virginia law applies to resolve unaddressed issues.

Uniform Partnership Act § 50-31 provides that the bankruptcy of any partner causes a dissolution of the partnership. See Va. Code Ann. § 50-31(5) (Michie 1950). On July 12, 1996, the filing date, two events occurred that were significant in this case. First, Shearin's pre-petition partnership interest became property of the estate, and second, the law firm dissolved. See *In re Weiss*, 111 F.3d 1159, 1167 (4th Cir. 1997) (holding that a partnership interest constitutes "property of the estate").

Although the partnership was in dissolution on the petition date on account of the filing of Shearin's petition, the law firm did not wind up its partnership affairs at that time or at any later date.[4] Instead, the law firm partners agreed to continue the business without liquidation of partnership affairs, thereby vesting title in the dissolved partnership's assets in the continued partnership, as authorized under Va. Code Ann. § 50-37.1.[5] The bankrupt estate succeeded to his pre-petition interest in the partnership.[6] It is not at once apparent why the

[4]Va. Code Ann. § 50-29 defined dissolution as a change in the relation of the partners caused by any partner ceasing to be associated in the carrying on, as distinguished from the winding up of the business. We also distinguished dissolution from termination after winding up of partnerships in *FDIC v. Hish*, 76 F.3d 620, 623 (4th Cir. 1996).

[5]Shearin remained as a partner in the continued partnership, and the law firm did not engage in a settlement of his pre-petition accounts. If the law firm had settled the accounts between the partners, the Code provided that the following distribution would have occurred: payment to creditors other than partners; payment to partners other than for capital and profits; payment to partners in respect of capital; and payment to partners in respect of profits. Va. Code Ann. § 50-40(2) (Michie 1950).

[6]A Chapter 7 Trustee has the duty to "collect and reduce to money the property of the estate for which the Trustee serves," 11 U.S.C. § 704(1), and the Trustee may sell property of the estate out of the ordinary course of business in order to obtain the money. 11 U.S.C. § 363(b)(1). Reducing a partnership interest to money either by selling the interest or by seeking a liquidation of all of the partnership assets to determine the amount attributable to the partnership interest is a problematic proposition due to the other partners' interests and the nature of the partners' rights in specific partnership property. See Va. Code Ann. § 50-25 (Michie 1950); see also *In re Manning*, 831 F.2d 205 (10th Cir. 1987); *In re Cutler*, 165 B.R. at 278-79.

Trustee could not have sold the partnership interest under 11 U.S.C. § 363(h), which gives a Trustee the power to sell estate property; however, the Trustee did not proceed in this manner. Furthermore, the law firm did not proceed to account for Shearin's partnership interest in any way either by settling his account or by winding up partnership affairs. Despite the law firm's inaction, Shearin's partnership interest became estate property, and the rights thereunder followed.

Shearin asserts that the Trustee could not at the time of the petition filing, and cannot at present, force the winding up of partnership affairs or the liquidation of the partnership assets. That question, however, is one we need not, and do not, decide, for the Trustee before us does not seek in this case authority for himself to force a winding up or a liquidation. The lack of such claim, however, does not give rise to any right of Shearin to keep pre-petition interests that stem from his partnership interest or his capital account.

We find the case of *Amsinck v. Bean*, 89 U.S. 395 (1874), persuasive, even if not controlling, and we follow that case. In *Amsinck*, in holding that the assignee (Trustee) of a bankrupt partner was not entitled to himself enforce the winding up of partnership affairs when that partner was bankrupt, the Court held that the other partner had to account to the Trustee of the bankrupt partner for the interest of the bankrupt in the partnership. It stated:

> Bankruptcy, it is said, when decreed by a competent tribunal, dissolves the copartnership, but the joint property remains in the hands of the solvent partner or partners, clothed with a trust to be applied by him or them to the discharge of the partnership obligations *and to account to the bankrupt partner or his assignee for his share of the surplus. Ex parte Norcross*, 5 L. R., 124; *Harvey v. Crickett*, 5 Maule & S., 339. (Emphasis added.)

395 U.S. at 403. While *Amsinck* was decided under the statutes in effect at that time, that very holding was applied by the Supreme Court of Washington, for example, as to the interest of a bankrupt partner in *Stickney v. Kerry*, 348 P.2d 655, 656 (Wash. 1960), in deciding how the interest of a bankrupt partner was treated. The holding of *Amsinck* and *Stickney* are consistent with the holding of *In re*

Cutler, 165 B.R. 265 (Bankr. D. Ariz. 1984), which treated the interest of the Trustee of a bankrupt partner as that of a creditor with a charging order.[7]

Shearin, as a Chapter 7 debtor, cannot retain the pre-petition interest and the profits stemming from it after it has become property of the estate. See 11 U.S.C. § 541(a)(6). The fact that the law firm chose to continue rather than to wind up and terminate does not shield Shearin from the reality that his pre-petition interest in the law firm, or the profits derived from that interest, became part of the bankrupt estate as of July 12, 1996. The law firm's practice of distributing profits at year-end does not take the partnership interest and its corresponding rights out of the estate.[8]

B.

The bankruptcy court also relied on the Bankruptcy Code's bright line distinction between the debtor's pre- and post-petition assets. Using the test first enumerated in *Segal v. Rochelle*, 382 U.S. 375, 380 (1966), and later reiterated in *In re Ryerson*, 739 F.2d 1423 (9th Cir. 1984), the bankruptcy court concluded that 85.6% of the year-end profits was directly traceable to the male debtor's pre-petition work and "sufficiently rooted in the pre-bankruptcy past." 739 F.2d 1423, 1426 (9th Cir. 1984) (holding that a portion of payment made upon termination of debtor's job was attributable to pre-petition work and within the bankruptcy estate). Similar to the court in *Ryerson*, we are concerned only with the distributed year-end profits to the extent the payments were related to pre-bankruptcy services, and we find that the amounts arrived at by the bankruptcy court were not arbitrary. 739

[7]The term charging order is defined in § 50-28 of the Code of Virginia as an order of a competent court to subject the interest of a debtor partner to the unsatisfied payment owed to a judgment creditor of that partner.

[8]Shearin argues that because the partnership agreement contains the provision, "Each partner shall receive such share of the partnership's net profits as shall, from time to time, be determined by the Management Committee" then the partner's interest in his share of the profits and surplus cannot exist until such determination is made. He asserts that the Management Committee's discretion make his right to share in profits a contingent or unvested right. We do not agree.

F.3d at 1425-26. In fact, the parties' stipulations as to Shearin's pre-petition generated receipts and the testimony of the law firm's committee member, support the bankruptcy court's determinations.

Courts in this and other jurisdictions have addressed the issue of whether post-petition payments are part of the estate in contexts other than post-petition distribution of partnership profits. See, e.g., *In re Andrews*, 80 F.3d 906 (4th Cir. 1996) (post-petition payment under pre-petition non competition agreement); *In re Palmer*, 57 B.R. 332 (Bankr. W.D. Va. 1986) (finding that because the debtor was required to perform certain post-petition services to receive payment, renewal commissions were not part of the estate). See also *In re Wu*, 173 B.R. 411 (B.A.P. 9th Cir. 1994) (finding that renewal commissions attributable to pre-petition services are part of the estate when paid post-petition). In *Andrews*, we recognized the pre-petition and post-petition distinction in our construction of § 541(a)(6). 80 F.3d 906, 910 (4th Cir. 1996). Although the facts in *Andrews* differ somewhat from those presented here, the construction of § 541(a)(6) instructs our decision today. Pre-petition assets or interests like Shearin's partnership interest are

> rooted in the debtor's pre-petition activities, including any proceeds that may flow from those [interests] in the future. Those [interests] belong to the estate and ultimately to the creditors. Post-petition assets are those that result from the debtor's post-petition activities and are his to keep free and clear of the bankruptcy proceeding.

80 F.3d at 910.

Regardless of Shearin's argument that the year-end distribution was contingent upon his remaining as a partner until the year-end distribution, we are of opinion that the bankruptcy court was correct in finding that "[Shearin] had a legally recognizable interest in profits of the law firm even though they were contingent and not subject to possession until some future time." The legally recognizable interest is the actual interest in the partnership, which is personal property of the debtor, and entitles him to share in the distribution of profits. That interest belonged to the estate and entitled the estate to become the recipient of these profits. In this case, the bankruptcy court appor-

tioned Shearin's profit distribution between pre-petition work and post-petition work. The partnership agreement does not provide that a partner must remain employed in order to receive his year-end distribution, but, even assuming that this requirement was in place, the bankruptcy court's reasoning followed the premise that even "[i]f some post-petition services are necessary, then courts must determine the extent to which the payments are attributable" to both the pre- and post-petition services. *Wu*, 173 B.R. at 414-15.

III.

The parties stipulated that the value of the capital account on the date of the petition was $28,844.10, all of which was contributed pre-petition and increased or decreased pre-petition. A "capital contribution by a partner is a debt of the partnership . . . ." 59A *Am. Jur. 2d* § 979. Again, the partnership agreement is silent on the return of capital accounts in the event of bankruptcy, but does outline the procedure for voluntary withdrawal or retirement. Upon voluntary withdrawal or retirement, a partner is entitled to his capital account in an amount shown on the partnership books at the close of the preceding calendar year, payable over ten years. The Uniform Partnership Act also treats capital contributions of partners as a liability owed by the partnership to those partners in the event of dissolution, winding up, and settlement of accounts. See Va. Code Ann. § 50-40(2)(c). Shearin asserted at trial that because the partnership agreement only provided for repayment of capital accounts in the event of retirement or voluntary withdrawal, the partnership agreement did not authorize the repayment of capital contributions in any other event. Shearin did not have to engage in post-petition activities to trigger his right of repayment of his capital contributions because his partnership interest was vested and not contingent upon anything. See Va. Code Ann. § 50-24, § 50-26 (Michie 1950) (the partnership interest is a property right of the partner and constitutes personal property). Even if repayment were conditioned on the firm's choice to settle its accounts,[9] the law firm's decision to continue does not entitle it to escape its obligations.[10]

[9]A "[capital account] constitute[s] a fund . . . for a ratable division of what is left among the partners." 59A *Am. Jur. 2d* § 331.

[10]If the law firm's affairs had been wound up and the accounts settled, Shearin's creditors would have benefited from whatever money was distributed to the partners according to their share in the partnership after all of the firm's other liabilities had been paid.

To resolve the disposition of the capital contribution, the bankruptcy court applied the bright line distinction between pre- and post-petition assets, and concluded that the account had accrued as a result of the male debtor's pre-petition work, similar to the year-end profits. Because a partnership interest also includes the right to be repaid capital contributions that are contributed pre-petition, see 59A *Am.Jur. 2d* at § 476, the estate is entitled to Shearin's capital account. We conclude that the capital account is property of the estate under state partnership and federal bankruptcy law: specifically, Virginia's Uniform Partnership Act's § 50-40, referring to capital contributions of partners as partnership liabilities; the overarching premise in § 50-41 that the continued partnership retained the liabilities and creditors of the old partnership; and § 541(a)(6) of the Bankruptcy Code, which excludes from property of the estate sums which are a result of and attributable to services performed by the debtor subsequent to his bankruptcy filing, all support our conclusion.

IV.

We find that the bankruptcy court's decision to award to the estate both the portion of distributed profits attributable to pre-petition work and the capital account was as good an approximation as could be made as to what Shearin's interest would have been, had the firm settled its accounts as of the date of the petition.[11] Furthermore, the bankruptcy court's analysis of §§ 541(a)(1) and 541(a)(6) justifies this result. The bankruptcy court is a court of equity, and it exercised its powers to ensure that "substance will not give way to form, [and] that technical considerations will not prevent substantial justice from being done." *Pepper v. Litton*, 308 U.S. 295, 304-05 (1939). Not only do the bankruptcy court's equitable powers support this outcome, but the Uniform Partnership Act explains that "[i]n any case not provided for . . . the rules of law and equity . . . shall govern." Va. Code Ann. § 50-5 (Michie 1950). Were we to rule otherwise, "debtors would be able . . . to circumvent the bankruptcy laws through" the use of their partnership agreements and reconstituted partnerships. *In re Andrews*, 80 F.3d 906, 911 (4th Cir. 1996) (finding that debtors may be inclined to use other agreements to divert monies under the guise of post-petition entitlement).

[11]No question is made in this case about other property of the law firm.

The judgment of the district court is accordingly

AFFIRMED.

PUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

In Re: NORMAN W. SHEARIN, JR.;
ANN SHEARIN,*
Debtors.

STEPHEN L. BEAMAN, Trustee,
Plaintiff-Appellee,

v.

VANDEVENTER BLACK, LLP,
Defendant-Appellant.

No. 98-2566

Appeal from the United States District Court
for the Eastern District of North Carolina, at Raleigh.
W. Earl Britt, Senior District Judge.
(CA-98-459-5-BR-2, BK-96-3403-8-L, AP-97-39-8-L)

Argued: April 7, 1999

Decided: August 17, 2000

Before WIDENER, MURNAGHAN, and WILKINS, Circuit Judges.

Affirmed by published opinion. Judge Widener wrote the opinion, in which Judge Murnaghan concurred. Judge Wilkins wrote a concurring and dissenting opinion.

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*Mrs. Shearin's name appears in some of the papers as Anne.

COUNSEL

ARGUED: Norman Wilson Shearin, Jr., VANDEVENTER BLACK, L.L.P., Kitty Hawk, North Carolina, for Appellant. Charlene Boykin King, BEAMAN & KING, P.A., Wilson, North Carolina, for Appellee. **ON BRIEF:** Michael P. Cotter, VANDEVENTER BLACK, L.L.P., Kitty Hawk, North Carolina, for Appellant. Stephen L. Beaman, BEAMAN & KING, P.A., Wilson, North Carolina, for Appellee.

OPINION

WIDENER, Circuit Judge:

Defendant, Vandeventer, Black, Meredith & Martin, L.L.P. (Vandeventer), appeals the district court's judgment affirming the bankruptcy court's order for turnover of funds to plaintiff, Stephen Beaman (the Trustee) in the matter of Norman Shearin, Jr. and Ann Shearin's Chapter 7 bankruptcy. The fund in the amount of $28,844.10 represents Shearin's capital account as an equity partner of the law firm, and the fund in the amount of $52,133.64 represents a portion of year-end profits distributed to him attributable to pre-petition work. We affirm.[1]

I.

We incorporate, as may apply here, the statement of facts from the related case, *Shearin v. Beaman*, No. 98-2191, today decided. We also follow that decision as it may apply here.

Additionally, the following facts are relevant in this adversary proceeding. After Shearin filed his petition in bankruptcy on July 12, 1996, the Trustee initially wrote the law firm on August 13, 1996.[2]

[1]The argument that the bankruptcy court had no jurisdiction is without merit.

[2]This inquiry occurred after the Trustee had hand delivered to Shearin's attorney a request for "[c]opies of any contracts, partnership agreements, or otherwise, that he has with his present law firm."

The Trustee requested information from the firm's managing partner regarding Shearin's partnership interests, along with any documents to assist him in the administration of the bankrupt estate. The firm promptly replied via letter on August 20, 1996 and denied that Shearin had any interest in undistributed profits of the law firm on July 12, 1996 "because there were no undistributed profits as of that date." In this same letter, the law firm disclosed to the Trustee that "Mr. Shearin's capital account was $28,844," but was inaccessible under the law firm's partnership agreement, enclosed with the letter. The dearth of information prompted the Trustee to inquire further into the profit issue in a September 11, 1996 letter to the law firm. The Trustee specifically asked about any work Shearin had credited at the date of filing that would lead to a distribution of profits at a later date.

The law firm did not respond to the Trustee's September inquiries. The Trustee wrote again on October 31, 1996 requesting the law firm's response within 10 days. Due to late receipt, the law firm responded to the request on November 27, 1996 asserting that the information requested was confidential and refusing to provide further information. The law firm's fiscal year ended on November 30, 1996. In accordance with the practice of the law firm since 1991, it paid to Shearin year-end distributions, $62,494.00 in December 1996 and $17,976.58 in January 1997. Ann Shearin deposited these checks into the Shearins' joint bank account. Shearin's capital account remained in the law firm's possession.

The bankruptcy court's decision *In re Shearin*, A.P. No. 97-00038-8-JLR, slip op. at 9-10 (Bankr. E.D.N.C. Feb. 17, 1998), resolved the issues of whether the capital account and the portion of year-end profits attributable to pre-petition work constituted property of the estate under 11 U.S.C. § 541 and Virginia partnership law. We have today affirmed the district court's judgment affirming the bankruptcy court in that case. See *Beaman v. Shearin*, No. 98-2191. The bankruptcy court decided in the companion proceeding, *Beaman v. Vandeventer, et al.*, A.P. No. 97-00039-8-JLR, slip op. at 10 (Bankr. E.D.N.C. Mar. 24, 1998), that the Trustee had the right to recover from the Vandeventer firm the value of the capital account and the pre-petition profits under 11 U.S.C. § 542(a). The district court affirmed that order.

We review this appeal from the district court's order *de novo*. See *In re Wilson*, 149 F.3d 249, 251 (4th Cir. 1998).

II.

This appeal requires us to construe 11 U.S.C. § 542 of the Bankruptcy Code, the turnover provision. Section 542(a) provides that one with possession or control of estate property "shall deliver to the trustee, and account for, such property or the value of such property . . . ." 11 U.S.C. § 542(a). Section 542(c) provides an exception to the turnover duty for parties who transfer property in good faith and with neither actual notice nor actual knowledge of the commencement of the bankruptcy case. See 11 U.S.C. § 542(c). The holder may also be excused from turnover duty if the property held is of inconsequential value to the estate. See 11 U.S.C. § 542(a). The firm argues that (1) neither the capital account nor the pre-petition profits distributed to Shearin post-petition are property of the estate; (2) the firm did not have possession, control, or custody of the profits at the time the adversary proceeding was brought; (3) the firm cannot turnover to the Trustee what it no longer has; and (4) at the time the firm paid the profits, it had a good faith dispute with the Trustee over the inclusion of profits and the capital account in the estate.

A.

We have today held in *Shearin v. Beaman*, No. 98-2191, that Shearin's capital account and the portion of year-end profits attributable to his pre-petition work constitute property of the estate.[3] We adhere to that holding here.

The law firm's second argument, that it had no possession of pre-petition year-end profits, applies exclusively to the turnover of those profits paid to Shearin.[4] The law firm paid Shearin his year-end prof-

[3]Throughout this opinion, such profits are referred to as property of the estate. Those profits are part of the estate under 11 U.S.C. § 541(a)(1) and (6). They flow from Shearin's partnership interest and his right to profits therefrom. See Va. Code Ann. § 50-24 and § 50-26 (Michie 1950).

[4]The law firm's second contention does not apply to the capital account because the law firm has remained in possession of Shearin's capital account throughout the bankruptcy case and these adversary proceedings. The account was valued at $28,844.10 on the date of the male debtor's petition. We agree with the bankruptcy court's assessment that this asset offers "substantial value to the estate . . . ."

its in December 1996 and January 1997, whereas this adversary proceeding began in March 1997, and the case began July 12, 1996 upon the filing of the petition. The claim is that such profits were paid to Shearin in December, 1996 and January, 1997, prior to the commencement of the adversary proceeding. Section 542(a) provides a broader remedy than solely the turnover of property held at the time of an adversary proceeding, which could occur well after the filing of a bankruptcy petition. It provides that "an entity . . . in possession, custody, or control, *during the case*, of property that the trustee may use, sell, or lease under section 363 . . . shall deliver to the trustee, and account for, such property or the *value* of such property . . . ." 11 U.S.C. § 542(a) (emphasis added). We construe the language "during the case" to refer to the entire bankruptcy case, not just the adversary proceeding.[5] *Accord Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. (In re USA Diversified Prods., Inc.)*, 100 F.3d 53, 55 (7th Cir. 1996) (applying section 542(a) to "[o]ne who during a bankruptcy proceeding is 'in possession, custody, or control' of property" belonging to the debtor's estate); *Redfield v. Peat, Marwick, Mitchell, & Co. (In re Robertson)*, 105 B.R. 440, 457 (Bankr. N.D. Ill. 1989) (stating that the statute "plainly applies to estate property that was possessed by anyone 'during the case' whether or not they still have it"). The law firm in this case had possession and control over pre-petition profits generated in the current fiscal year before July 12, 1996, the date of the bankruptcy filing,[6] and retained control and possession of those profits until year-end distribution in December 1996 and January 1997. Accordingly, Shearin's year-end profits, pro-rated to July, 12, 1996, are subject to turnover, and the firm, having possessed[7] such profits must "account for" that property "or the

[5]For the general distinction between a case and proceeding in bankruptcy see 3 Norton, *Bankruptcy Law & Practice* § § 138:2; -3 (2d ed. 1997).

[6]Before trial in the companion proceeding, the parties stipulated that between December 1, 1995 and June 30, 1996, Shearin's receipts totaled $276,229.00, and that his year-end receipts totaled $322,443.00. The bankruptcy court concluded that 85.6% of the debtor's receipts and contribution to the year-end profits, were generated pre-petition.

[7]We know that the law firm had control of these profits during the bankruptcy proceedings because it dispersed bi-monthly draws to the male debtor and adjusted his year-end distribution to reflect those advancements, pursuant to the partnership agreement.

value of said property." See *In re USA Diversified Prods., Co.*, 100 F.3d at 55 (quoting section 542(a)).

The firm's third contention concerns its lack of possession and inability to turn over the profits already distributed which is answered by *In re USA Diversified Prods., Co.*, with which we agree. The court in that case decided that section 542(a) "requires the delivery of the property or the value of the property" and that to read it otherwise would enable possessors of property of the estate to escape trustees' demands "simply by transferring the property to someone else." 100 F.3d at 56.

We also agree with the court's construction of § 542(c) in *Diversified Products*, that an overly literal construction of § 542(c) is not the correct construction of that provision. For example, merely "actual notice" or "actual knowledge of the commencement of the case" is not alone sufficient to impose liability upon a holder of the property of the bankrupt unless "the relevant knowledge or notice is knowledge or notice to a possessor of property that a bankruptcy proceeding had begun *and* that the property in the possessor's custody was property of a debtor in that bankruptcy proceeding." 100 F.3d at 57. In the case at hand, the letters passing between the Trustee and Vandeventer and the trial testimony and exhibits not only show that the firm knew that the bankruptcy case had begun, but also that the interest of Shearin in the pre-petition profits and in the capital account was claimed by the Trustee to be the property of Shearin in that bankruptcy.

The fact that the firm paid the pre-petition profits to Shearin prior to the filing of the adversary proceeding by the Trustee is also raised as a defense. The firm, as controlling authority, relies on our decision in *Hager v. Gibson*, 109 F.3d 201 (4th Cir. 1997), which the firm characterizes as holding that the property in question to be subject to the turnover statute, § 542(a), "must be in the present possession [of the law firm] when the adversary proceeding was brought." Br. p.32. Vandeventer's reliance on that part of our opinion, see *Hager*, 109 F.3d at 211, upon which the sought-for conclusion is based, relating to Hager's lack of possession at the time of the adversary proceeding, however, is entirely misplaced. In the *Hager* case, we held that, because Hager did *not* have possession of the money at any time, "Hager, therefore, has not possessed either the $40,000 or any pro-

ceeds from its use as a result of that transaction and may not, for that reason, be required to turn the sum over under § 542(a)." 109 F.3d at 210-11. The notation in the opinion of the bankruptcy court in this case, that Hager's receipt and disposal of the sum of $40,000 pre-petition made the case clearly outside of § 542(a)'s reach, was correct as far as its reference to time goes, but its statement that Hager had received the property pre-petition is simply an error.

In sum, Shearin's partnership interest was property of the debtor and became property of the estate on July 12, 1996. This interest entitled Shearin to the year-end profits flowing from his pre-petition work and to his capital account, which he had contributed pre-petition. See *Shearin v. Beaman*, No. 98-2191. The law firm knew enough to "place a reasonable person on notice, requiring the firm to conduct a reasonable inquiry to determine" the proper disposition of the profits and capital account. *In re USA Diversified Prods., Inc.*, 100 F.3d at 57. The bankruptcy court's assessment of the law firm's duty to "consult with the [T]rustee or make sufficient inquiry into the relevant facts before distributing the profits" was correct.

Any argument of Vandeventer to the effect that the Trustee had elected a remedy by proceeding first against the Shearins is without merit. The Trustee may make only one collection, however. We note that the argument of Vandeventer is divided into eight separate parts, plus two sub-parts. We have tried to consider all of them. Any omission on our part to have mentioned every such assignment of error explicitly in our opinion is no indication it may have merit, for we have considered all of the points raised and are of opinion that none have merit.

The judgment of the district court is accordingly

AFFIRMED.

WILKINS, Circuit Judge, concurring in part and dissenting in part:

The majority affirms the order of the district court in its entirety. I agree that Shearin's capital account and the portion of the year-end profits attributable to his pre-petition work constitute property of the

estate. However, I believe the bankruptcy court erred in ordering the law firm to turn over the amount of the 1996 year-end profit disbursement because the firm had already relinquished possession of the disbursement by the time this adversary proceeding was commenced. I therefore respectfully dissent from the majority opinion to the extent that it holds otherwise.

Section 542(a) of Title 11 provides:

> Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

11 U.S.C.A. § 542(a) (West 1993).

Citing *Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. (In re USA Diversified Prods., Inc.)*, 100 F.3d 53, 56 (7th Cir. 1996) [hereinafter *Diversified*], the majority concludes that § 542(a) does not require that the profits have been possessed by the law firm at the time the turnover petition was initiated in order for the statute to apply. *See ante*, at 6. Were we writing on a clean slate, I might be inclined to follow *Diversified* as well. However, we are not writing on a clean slate, as this court adopted a contrary interpretation of § 542(a) in *Hager v. Gibson*, 109 F.3d 201, 210-11 (4th Cir. 1997). *See Smith v. Moore*, 137 F.3d 808, 821 (4th Cir. 1998) ("It is well established that a decision of this Court is binding on other panels unless it is overruled by a subsequent *en banc* opinion of the Court or an intervening decision of the United States Supreme Court."); 3 William L. Norton, Jr., *Norton Bankruptcy Law and Practice 2d* § 52:4, at 6 n.12.5 (Supp. 2000) (noting conflict between *Diversified* and *Hager*).

In *Hager*, a bank made a $150,000 loan to a corporation, and the loan was personally guaranteed by the corporation's two fifty-percent stockholders, Hager and Roop. *See Hager*, 109 F.3d at 203. When the

loan balance stood at $129,764.04, Hager purchased the note from the bank, using a $40,000 check drawn on the corporate account and an $89,764.04 check drawn on his personal account. *See id.* When the corporation subsequently filed for bankruptcy, the Trustee brought an action seeking, *inter alia*, the $40,000. *See id.* at 204. The bankruptcy court granted summary judgment to the Trustee, and the district court affirmed. *See id.* at 206.

This court analyzed the issue of whether the Trustee could obtain the $40,000 under the turnover statute as follows:

> Hager contends that this section does not authorize recovery of the $40,000 applied in payment of the . . . note because he was not, *when the adversary proceeding was brought*, "an entity in possession, custody, or control during the case" of that property. We agree. *Present possession, either actual or constructive, of the property or its identifiable proceeds, by the person from whom its turnover is sought, is required for recovery under this section. See Maggio v. Zeitz*, 333 U.S. 56, 64, 68 S. Ct. 401, 405-06, 92 L. Ed. 476 (1948) (applying pre-code judicially developed turnover principles in so holding); *In re Sun Spas by Schaeffer, Inc.*, 122 B.R. 452, 455 (Bankr. M.D. Fla. 1990); *In re Gailey, Inc.*, 119 B.R. 504, 514 (Bankr. W.D. Pa. 1990). Here, the Trustee contends that Hager was in possession of proceeds of the $40,000 *when the adversary proceeding was brought* by virtue of his ownership of the . . . note partially purchased with that sum. But, as we have previously pointed out, that misstates the nature and effects of that transaction. Rightly analyzed, the $40,000 was applied to reduce [the corporation's] indebtedness on the note, thereby reducing the balance owing upon it, hence its value upon Hager's then purchasing it from [the bank] with his own check for the balance remaining. Hager therefore has not possessed either the $40,000 or any proceeds from its use as a result of that transaction and may not for that reason be required to turn the sum over under § 542(a).

Id. at 210-11 (emphasis added).

As the excerpt indicates, Hager's challenge was based entirely on the fact that he lacked possession of the $40,000 or its proceeds when the turnover proceeding was initiated, and our reversal of the district court was based solely on our application of the rule that possession of property or its proceeds at the time the adversary proceeding is initiated is required in order for the property to be subject to the turnover statute.*_See id._ at 210. Because the law firm here was not in possession of the disbursement or any proceeds thereof when the adversary proceeding was initiated, I would apply the rule announced in *Hager* and hold that the bankruptcy court erred in ordering the firm to turn over funds in the amount of the disbursement.

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*The majority opinion implies that the result in *Hager* was based on the fact that Hager *never* had possession of the $40,000 or its proceeds, not on the mere fact that he did not possess the money when the turnover proceeding was initiated. *See ante*, at 6. Although we mentioned in *Hager* that Hager actually never possessed the $40,000 or its proceeds, we noted that fact only in the context of explaining that Hager did not possess the $40,000 or its proceeds when the turnover proceeding was initiated. *See Hager*, 109 F.3d at 210-11.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT
[Filed September 12, 2000]

NO. 98-2566

In Re: NORMAN W. SHEARIN, JR.; ANN SHEARIN,
Debtors.

STEPHEN L. BEAMAN, Trustee,
Plaintiff-Appellee,

versus

VANDEVENTER BLACK LLP

ORDER

A petition for rehearing and rehearing en banc was filed by Vandeventer Black on August 31, 2000.

No request for a poll of the court having been made, it is accordingly ADJUDGED and ORDERED that the petition for rehearing en banc shall be, and it hereby is, denied.

Judge Wilkins, as a member of the panel, voted to grant the petition for rehearing, and Judge Widener voted to deny the petition for rehearing. Judge Murnaghan, the third member of the panel, having died August 31, 2000, did not consider the petition for rehearing.

It is accordingly ADJUDGED and ORDERED that the petition of rehearing shall be, and it hereby is, denied for want of a majority.*

/s/ H.F. Widener, Jr.

For the Court

* This order is filed by a quorum of the panel under 28 U.S.C. §46(d).

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NORTH CAROLINA
WESTERN DIVISION
[Filed July 20, 1998]

No. 5:98-CV-381-BR

IN RE:	)	
NORMAN W. SHEARIN, JR.	)	
and ANNE S. SHEARIN,	)	
Appellants,	)	ORDER
v.	)	
STEPHEN L. BEAMAN, Trustee,	)	
Appellee.	)	

Debtor-appellants filed timely notice of this appeal on 27 February 1998 pursuant to Rule 8001 of the Federal Rules of Bankruptcy Procedure and 28 U.S.C. §158. Debtor-appellants appeal for review of the 17 February 1998 order entering judgment against them in the United States Bankruptcy Court for the Eastern District of North Carolina. That order was entered by United States Bankruptcy Judge J. Rich Leonard and held that Mr. Shearin's capital account in the amount of $28,844.10 constituted property of the estate at issue in this matter. The order also directed that judgment be entered in favor of plaintiff-appellee against debtor-appellants in the amount of $52,133.64.

The proper standard of review on appeal is set out in Rule 8013 of the Federal Rules of Bankruptcy Procedure. This court may affirm, modify, or reverse a bankruptcy judge's judgment, or decree. The Bankruptcy Court's findings of fact will not be set aside unless clearly erroneous, but questions of law are reviewed *de novo.*

After careful consideration of the order entered by Judge Leonard, and upon full review of the record on appeal,

the decision of the Bankruptcy Court in this matter is hereby AFFIRMED.

This 17 July 1998.

/s/

W. EARL BRITT
Senior United States District Judge

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NORTH CAROLINA
WESTERN DIVISION
[Filed October 2, 1998]

No. 5:98-CV-459-BR2

IN RE: Norman W. Shearin, Jr. Anne S. Shearin	)	
VANDEVENTER BLACK LLP, Appellant,	)	ORDER
v.	)	
STEPHEN L. BEAMAN, Trustee, Appellee.	)	

This matter is before the court on appeal from an order of the Bankruptcy Court dated March 24 1988. In that order, Bankruptcy Judge J. Rich Leonard directed appellant to turnover funds to appellee in the amounts of $28,844.10 and $52,133.64. The parties have fully briefed the issues. Upon full consideration, the order of the Bankruptcy Court is AFFIRMED

This October 2, 1998.

/s/

W. EARL BRITT
Senior U.S. District Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NORTH CAROLINA
WILSON DIVISION
[Filed February 17, 1998]

IN RE:
NORMAN W. SHEARIN, JR., CASE NO. 96-03403-8-JRL
and ANN SHEARIN,
DEBTORS.

STEPHEN L. BEAMAN, ADVERSAY PROCEEDINGS
Trustee, PLAINTIFF, NO. L-97-00038-8-AP
v.
NORMAN W. SHERAIN, JR.,
and ANN SHEARIN,
DEFENDANTS.

ORDER

The trustee brings this adversary proceeding seeking to recover property of the estate and to revoke the debtors' discharge pursuant to §727 of the Bankruptcy Code. A trial was held on January 15, 1998 in Wilson, North Carolina. This court has jurisdiction to determine this matter as a core proceeding under 28 U.S.C.§157(b)(2)(E) and (b)(2)(J).

Findings of Fact

1. The debtors filed a voluntary petition for relief under Chapter 7 on July 12, 1996, and Stephen L. Beaman was appointed trustee.

2. Norman W. Shearin, Jr. is an attorney and equity partner in the law firm of Vandeventer, Black, Meredith and Martin, L.L.P., ("law firm") a registered limited liability partnership in Virginia with offices in Norfolk, Virginia and Kitty Hawk, North Carolina.

3. The debtors listed an interest in the law firm partnership as an asset with a zero dollar market value on Schedule B attached to their petition.

4. Upon the fling of the bankruptcy petition, the remaining partners in the law firm continued the partnership without adopting a new partnership agreement or making any organizational changes. In addition, the male debtor continued to participate in the partnership. This reconstituted partnership assumed the obligations of the former.

5. The law firm's fiscal year runs from December 1 to November 30 of the following year. Michael P. Cotter ("Cotter"), a member of the law firm's management committee, explained the allocation of profits among the partners. At the close of each fiscal year the law firm divides the money into 2 portions: objective and subjective. According to the partnership agreement, the partners are evaluated objectively, based on a ratio comparing the three-year average of their receipts to the three-year average of all partners' receipts, as well as on their subjective value to the law firm. Each partner is assigned 2 percentages, one representing the objective determination and the other, the subjective, to be applied to the respective portions of money.

6. The parties have stipulated that between December 1, 1995 and June 30, 1996, the male debtor's receipts totaled $276,229.00. For the entire fiscal year ending November 30, 1996, the male debtor generated receipts of $322,443.00. Therefore, 85.6% of the male debtor's receipts were generated within the first 7 months of the fiscal year.

7. The male debtor's three-year average of receipts for the years 1994, 1995 and 1996, amounted to $548,545.00. For the fiscal year ending November 30, 1996, the male debtor received 3.01% of the objective portion of the profits and 5% of the subjective portion. Cotter testified that the filing of the male debtor's bankruptcy petition did not negatively impact his subjective evaluation by the management committee for the year.

8. The male debtor received 2 checks, one in the amount of $62,494.00 in December 1996 and another in the amount of $17,976.58 in January 1997, from the law firm representing his portion of the year-end profits. The male debtor only netted $76,042.75 of the total disbursements. The adjustment reflected the repayment of sums the law firm had advanced to the male debtor earlier in the fiscal year.

9. The female debtor deposited the checks into the debtor's joint bank account knowing that the checks represented her husband's year-end profit distribution.

10. The male debtor had received similar year-end profits distributions in December of each year since 1991, the time that the male debtor became an equity partner in the law firm.

11. In addition to year-end profit distributions, the male debtor received compensation through bi-monthly draws based on his seniority in the law firm. In 1996, these bi-monthly draws were in the approximate amount of $4,375.00.

12. According to customary practice in the law firm, partners are only entitled to the bi-monthly draws and possess no interest in profits until such profits, if any, are calculated at the end of the fiscal year. The single partner who left the law firm prior to the end of the fiscal year did not participate in the year-end profit distributions.

13. According to the partnership agreement, each partner also possesses an interest in a capital account in the law firm. As of June 12, 1996, the male debtor had accumulated value of $28,844.10 in his capital account. Under the agreement, no partner is entitled to his or her capital account except in the event of the partner's voluntary withdrawal or retirement from the law firm.

14. At the 341 meeting, the trustee inquired as to the male debtor's partnership interest. The debtor responded that he had no interest in any law firm profits as of the date of the petition.

15. The trustee also wrote the law firm and requested information and an accounting of the law firm's profits for 1996. The law firm responded by sending a copy of the partnership agreement to the trustee. Additionally, the law firm requested a confidentiality agreement from the trustee before provided further information.

16. The debtor's discharge was entered on November 8, 1996.

17. Despite numerous requests for information, neither the debtors nor the law firm consulted with the trustee prior to the disbursement and receipt of the year-end profits distributions.

18. The trustee learned of these distributions in January 1997.

Conclusions of Law

In accordance with his duty to collect property of the estate, the trustee seeks the turnover of a portion of the male debtor's profit distributions for the fiscal year ending November 30, 1996 and the male debtor's capital account, representing his interest in the law firm as of the date of the petition. The trustee also asserts violations of §727 and seeks to have the debtor's discharge revoked.

Property of the Estate

The filing of a petition under Title 11 of the United States Code creates a bankruptcy estate. 11 U.S.C. §541(a). Section 541 defines property of the bankruptcy estate as "all legal or equitable interests of the debtor in property as of the commencement of the case" regardless of the location of the property. Id. In a Chapter 7 case, the trustee succeeds to the debtors interest in the property and has the power under §542 to request the turnover of estate property. See 11 U.S.C. §541(a).

A debtor's property interests are governed by the applicable state law in effect at the time of the bankruptcy

filing. Barnhill v. Johnson, 503 U.S. 393, 398(1992) (citing Butner v. United States, 440 U.S. 48, 54(1979)). The parties have stipulate that Virginia partnership law governs the partnership and partnership agreement. Therefore, where the partnership agreement is silent, Virginia law applies to resolve unaddressed issues.

The partnership agreement grants a partner rights and interests in partnership property and in the partner's capital account. However, the agreement fails to address the consequences of a partner's bankruptcy and is silent as to the partner's right in profits and capital accounts upon the filing of bankruptcy. Therefore, §50-31(d)(5) of the Virginia Code applies and provides that the filing of a bankruptcy petition by a partner dissolves the partnership. VA. CODE ANN. §50-31(d)(5) (Michie 1950).

The Fourth Circuit discussed the distinction in Virginia partnership law between dissolution and termination of partnerships in FDIC v. Hish, 76 F.3d 620, 623 (4th Cir. 1996). On dissolution, the partnership is not terminated but continues until the winding up of partnership affairs is completed. See id. at 623 (quoting VA. CODE ANN. §50-30 (Michie 1950). A liquidation of assets upon dissolution is not required; the remaining partners may choose to continue the partnership and to settle accounts with the partner causing the dissolution. VA. CODE ANN. §50-37.1 (Michie 1950); see In re Cutler, 165 B.R. 275, 278 (Bankr. D. Ariz. 1994). With the continuation of a partnership, the liabilities of the former entity are assumed by the new one. VA. CODE ANN. §50-41(1) (Michie 1950).

It is well settled that a debtor's partnership interests on the date of the petition become property of the bankruptcy estate. See e.g. In re Antonelli, 4 F.3d. 984 (4th Cir. 1993) (Unpublished) (Table, Text in Westlaw) (citing In re Cardinal Indus., Inc., 105 B.R. 834, 848 (Bankr. S.D. Ohio 1989); In re Plunkett, 23 B.R. 392, 393-94 (Bankr. E.D. Wis. 1982)). The Fourth Circuit has held that general partnership interests become property of the estate in a Chapter 11 case. Antonelli, 4 F.3d at *6. In another example, the Cutler court held that the trustee was entitled to "receive his full one-quarter share of all surplus and profits, if and when such surplus and profits are realized." Cutler, 165 B.R. at 282.

Here, the bankruptcy filing of the male debtor dissolved the partnership under Virginia partnership law. The partners, including the male debtor, elected to continue rather than liquidate and terminate, the partnership. However, the partnership never settled the account of the dissolving partner, the male debtor, and the trustee succeeded to his interest as of the date of the petition. Because the new partnership has assumed the debts of the old partnership, the obligations owed to the trustee, as successor in interest to the dissolving partner, remain outstanding.

The male debtor's interest in the partnership as defined under Virginia partnership law is two-fold: his right to receive compensation and his right to receive his capital account. VA. CODE ANN. §50-24 (Michie 1950). The trustee asserts an interest in the year-end profit distributions received by the debtors in December 1996 arguing that the

amount, in part, is compensation for pre-petition work performed by the debtor. The debtors contend that they had no right to any profits as of the petition date, that the male debtor's right to the profits arose post-petition, and that the profits are not property of the Chapter 7 bankruptcy estate.

Section 541(a)(6) includes in the bankruptcy estate after-acquired property consisting of "[p] roceeds, product, offspring, rents, and profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case." 11 U.S. C. §541(a)(6). In amendments to the Bankruptcy Code, Congress has "indicated its intention to include all legally recognizable interests although they may be contingent and not subject to possession until some future time." In re Ryerson, 739 F.2d 1423, 1425 (9th Cir. 1984) (citing H.R.Rep. No. 595, 95th Cong., 1st Sess. 175-76 (1977). The test is whether the after-acquired property is "sufficiently rooted in the pre-bankruptcy past as to be included within the bankruptcy estate." Id. at 1426.

The Ryerson case offers some striking similarities to the present one. There, the debtor possessed an interest in a "contract value" that accrued during his tenure and to which he was entitled to receive upon termination of his job. Id. at 1424. The debtor filed for relief under Chapter 7 on February 10, 1981, but his job contract did not terminate until November 1, 1981. Id. The debtor sought a declaratory judgment that the sum he was eligible to receive was not property of the estate. Id. at 1424-25. However, the court determined that the language of §541(a)(6) implied that

"earnings from services performed prior to the bankruptcy are includable within the bankruptcy estate" and that a portion of the debtor's earnings were sufficiently rooted in the pre-bankruptcy past as to be included within the estate. Id. at 1426. The portion related to services performed after the date of the petition was deemed the separate property of the debtor. Id.

In the present case, the profits distributed by the law firm in December of 1996 were based on calculations including the male debtor's receipts for the period from December 1, 1995 to July 12, 1996. A large number of the receipts for the fiscal year, contributing to the 3 year averaged used by the firm in its calculation, were earned during this period. A substantial portion of the profits received by the debtors resulted from work sufficiently rooted in the pre-bankruptcy period. As in Ryerson, the male debtor had a legally recognizable interest in profits of the law firm even though they were contingent and not subject to possession until some future time. See Ryerson, 739 F.2d at 1425. Therefore, the portion of the year-end profits directly traceable to the male debtor's pre-petition work shall be included as property of the bankruptcy estate. A different result would allow the debtors to have discharged substantial debt incurred during the first half of 1996, while keeping from their creditors earnings directly attributable to the same time period. A court of equity cannot countenance such a result.

In tracing the amounts into the pre-petition period, the testimony of Cotter, a member of the law firm's

compensation committee, is helpful. Cotter explained that the male debtor was awarded 3.01% of the objective portion of the profits and 5% of the subjective portion, or approximately 8% of the total profits allocated among the partners in fiscal year 1995-1996. The objective percentage, 3.01%, represents approximately 37.5% of the male debtor's total percentage of 8%. Therefore, 37.5% of $76,042.75, or $28,516.03, represents the profits received by the male debtor from the objective pool. Then, the amount received under the subjective assessment can be determined by subtracting $28,516.03 from $76,042.75, for a difference of $47,526.72.

Because 85.6% of the male debtor's receipts were generated within the first 7 months of the fiscal year, the trustee is entitled to 85.6% or $28,516.03, the objective portion of profits received by the male debtor, or $24,409.72. Because the bankruptcy appeared to have no effect on the management committee's subjective assessment of the male debtor, it is assumed that his subjective worth to the law firm remained constant throughout the fiscal year. Thus, the amount received under this formula can simply be prorated over the 7 months worked prior to the filing of the petition. Therefore, $27,723.92 of the subjective portion of profits received by the male debtor were rooted in the pre-petition period. Accordingly, the court concludes that $52,133.64 of the $76,042.75 received by the debtors is directly traceable to the male debtor's pre-petition work and is property of the estate.

The issue regarding the male debtor's capital account is also answered by the Ryerson opinion. There, the debtor's "contract value" increased proportionally with the length of his employment, much like the male debtor's capital account with the law firm in this case. See Ryerson, 739 F. 2d at 1425. In another similarity, the debtor in Ryerson was entitled to receive the value upon termination of his job contract, just as partners in the law firm are entitled to receive their capital account upon voluntary retirement or withdrawal from the firm. See Id. In Ryerson, the court found that the termination payments received by the debtor represented "value for years of service completed prior to bankruptcy" and were sufficiently rooted in the pre-bankruptcy past as to be included within the estate. Id. at 1426.

The court agrees with the analysis in Ryerson and finds the facts of this case indistinguishable. The parties have stipulated that the value of the capital account on the date of the petition was $28,844.10. This entire amount accrued as a result of the male debtor's pre-petition work. Therefore, $28,844.10 of the capital account is sufficiently rooted in services performed pre-bankruptcy and is property of the estate.

Revocation of Discharge

The trustee seeks to revoke the debtor's discharge on two grounds. First, the trustee alleges that the debtors violated §727(a)(2)(B) when they received the profits from the law firm, deposited the money in their account and used the money for their own purposes without consultation with

the trustee. Second, the trustee argues that the debtors withheld financial information necessary to the administration of the case in violation of §727(a)(4)(D). The debtors deny that they have failed to cooperate with the trustee and dispute the trustee's position that the assets are property of the estate.

Both subsections of §727 cited by the trustee require some evidence of fraudulent intent on the part of the debtors. See 11 U.S.C. §727(a)(2)(B) ("[w]ith intent to delay, hinder or defraud a creditor...") and §727(a)(4)(D) ("[t]he debtor knowingly and fraudulently..."). The trustee has failed to demonstrate any fraudulent intent on the part of the debtors. The lack of cooperation on the part of the debtors appears to result from a good faith dispute with the trustee regarding the correct interpretation of the law. The court recognizes the debtor's arguments as ones made in good faith and declines to deny their discharge under §727.

Conclusion

Based on the foregoing, the clerk is directed to enter judgment in favor of the plaintiff and against the debtors in the amount of $52,133.64. In addition, the male debtor's capital account in the amount of $28,844.10 constitutes property of the estate, and the trustee is free to seek its recovery in whatever manner he deems appropriate. Relief as to all other claims is denied

So Ordered.

Date:

/s/
J. Rich Leonard
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NORTH CAROLINA
WILSON DIVISION
[Filed March 24, 1998]

IN RE:
NORMAN W. SHEARIN, JR., CASE NO. 96-03403-8-JRL
and ANN SHEARIN,
DEBTORS.

STEPHEN L. BEAMAN, ADVERSAY PROCEEDINGS
Trustee, PLAINTIFF, NO. L-97-00039-8-AP
v.
VANDEVENTER, BLACK,
MEREDITH & MARTIN, L.L.P.,
DEFENDANT.

ORDER

The trustee brings this adversary proceeding seeking to recover property of the estate. A trial was held on March 11, 1998 in Wilson, North Carolina. This court has jurisdiction to determine this matter as a core proceeding under 28 U.S.C. §157(b)(2)(E).

Findings of Facts

At the outset of the trial, the parties stipulated to introduction of the records in the companion adversary proceeding, Beaman v. Shearin (In re Shearin), A.P. No. L-97-00038-8-AP, tried in this court on January 15, 1998 with the exception of Exhibits 8-12 and 19. After consideration

of these stipulations and the additional evidence presented at trial, this court expressly adopts findings of facts numbers 1-8, 10 and 12-18 from Beaman v. Shearin (In re Shearin), A.P. No. L-97-00038-8-AP, slip op. at 1-4 (Bankr. E.D.N.C. Feb. 17, 1998). The court makes further findings of facts based on the evidence presented at the trial as follows:

1. On August 13, 1996, the trustee wrote to Charles Tucker ("Tucker"), the managing partner of Vandeventer, Black, Meredith & Martin, L.L.P. ("Vandeventer"), advising him of his appointment as trustee in the debtor's bankruptcy case.

2. The trustee related information offered by the male debtor at his 341 meeting of creditors. Based on this, the trustee informed Tucker of his belief that the male debtor possessed an interest in the undistributed income of the law firm partnership, a share of partnership assets, and an ERISA qualified retirement plan. In this letter, the trustee requested documents relating to these assets.

3. On August 20, 1996, Vandeventer responded by enclosing certain documents, including the partnership agreement, and denying that the male debtor had any interest in undistributed profits of the law firm because there were no undistributed profits as of the date of the petition.

4. The trustee wrote another letter dated September 20, 1996, requesting more information regarding the undistributed profits. The trustee specifically inquired as to whether the male debtor had work in progress as of the date of the filing that might lead to "a distribution of profits to him at a later date." The trustee also objected to Vandeventer's request that the documents "be kept confidential and not distributed to any person or entity."

5. Vandeventer did not respond to the trustee's second letter. The trustee again wrote Vandeventer on October 31, 1996 requesting a response within ten days. Because of an incorrect zip code, this letter did not arrive at Vandeventer's office until November 15, 1996.

6. On November 27, 1996, Vandeventer replied requesting that its confidentiality concerns be addressed before providing additional documents and information on the male debtor's compensation for fiscal year 1996. This letter was received by the trustee on December 2, 1996.

7. Vandeventer made its annual profit distribution to its partners, including the male debtor, in mid-December 1996 and in January 1997. As of the date of trial, the male debtor's capital account has not been paid to him or to the trustee.

Conclusions of Law

In the companion adversary proceeding, this court held that the male debtor's capital account in the amount of $28,844.10 and a portion of the profits distributed to the male debtor, in the amount of $52,133.64, constituted property of the estate under §541. Beaman v. Shearin (In re Shearin), A.P. No. 97-00038-8-JRL, slip op. at 9-10 (Bankr. E.D.N.C. Feb. 17, 1998). The court entered a judgment in the above amounts against the debtors. See id. at 10. Now, the trustee seeks a judgment and the right to recover against the law firm, Vandeventer that holds the capital account and is responsible for distributing the profits to the male debtor. In the interest of efficiency, this court expressly adopts its conclusions of law from its order in the companion proceeding. See id. at 4-11. Thus, the liability of Vandeventer under §542 remains the only unresolved issue between the parties.

Section §542

Section 542(a) imposes a duty on those holding property of the estate to turnover that property to the trustee. 11 U.S. C. §542(a). The only exceptions to this duty are found in subsection (c) that protects those who transfer property in good faith without any knowledge of the bankruptcy case and subsection (d) that protects life insurance companies in certain circumstances. See 11 U.S.C.

§542(c)(d). Therefore, under the plain language of §542(a), a trustee must demonstrate four elements to force the turnover of property of the estate: 1) that during the case, 2) an entity other than a custodian, 3) was in possession, custody, or control; of property that the trustee could use, sell or lease, and 4) that such property is not of inconsequential value or benefit to the estate. See 11 U.S.C. §542(a); Boyer v. Davis, et al (In re U.S.A. Diversified Products, Inc.), 193 B.R. 868, 872 (Bankr. N.D. Ind.1995).

The trustee has carried his burden of establishing the four required elements. First, it is undisputed the Vandeventer held and distributed the profits in December 1996, well after the petition date in July, 1996, and that Vandeventer currently maintains possession of the male debtor's capital account. Second, it is undisputed that Vandeventer was not acting as a custodian, as defined under §101(11), with respect to the profits. See 11 U.S.C. §101(11). Third, the funds have been previously found to be property of the estate, and accordingly, the trustee may use them in the administration of the case. See 11 U.S.C. §363(b); Beaman v. Shearin (In re Shearin), A.P. No. 97-00038-8-JRL, slip op. at 9-10 (Bankr. E.D.N.C. Feb. 17, 1998). Finally, the amount of funds sought by the trustee totals $80,977.74, a significant amount.

Vandeventer contends that a partner's capital account does not represent actual funds held by the law firm, and therefore, the capital account does not represent any tangible "value" for the estate. However, the partnership agreement provides for the payment of the capital account upon the voluntary retirement or withdrawal of a partner. Obviously, the account represents some amount of value actually held by Vandeventer, and the law firm is bound to the figures found on its books. The court determines that the assets offer substantial value to the estate and that the trustee has satisfied the requirements of §542(a).

Defenses

Vandeventer offers several arguments as to why it should not be held liable for the profit distributions made to the male debtor: 1) that it had no notice or knowledge that the profits were property of the estate; 2) that the trustee failed to make a timely demand for the funds or to place Vandeventer on notice of the estate's interest; and 3) that Vandeventer cannot be required to turnover property it no longer possesses.

Notice

First, Vandeventer asserts the exception outlined in §541(c) because it had no actual notice or knowledge sufficient to prevent it from making a distribution of funds to the make debtor. See 11 U.S.C. §542(c). However, the plain language of the statute protects only those who have "neither actual notice nor actual knowledge of the commencement of the case concerning the debtor..." See id. Vandeventer does not deny its knowledge of the debtor's bankruptcy filing but argues instead that it never believed that the funds were property of the estate. Further, Vandeventer asserts that a ruling against the law firm would be unfair as it penalizes the firm for failing to anticipate the court's ruling classifying the funds as property of the estate.

In essence, Vandeventer argues an equitable defense outside of the statute, protecting possessors who possess knowledge of the bankruptcy but do not know that the property they possess is property of the estate. See Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A., (In re U.S.A. Diversified Products, Inc.). 100 F.2d 53, 55 (7th Cir. 1996) (law firm argues "nonstatutory equitable defense"). The Seventh Circuit in Carlton, Fields rejected this notion of equitable defenses holding that the exception provided in §542(c) supplanted the equitable concepts used earlier to protect innocent transferors. See id. at 56. Then,

the court returned to the language of §542(c) and gave it a "sensible" interpretation holding that "notice of circumstances that would lead a reasonable person to inquire further" is sufficient to defeat a defense under the subsection. See id. at 57.

Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. ("Carlton, Fields"), a Florida law firm, was retained by Paul Davis ("Davis") to represent him, his wife and his company, U.S.A. Diversified Products, Inc., in a suit for fraud. Carlton, Fields, 100 F. 3d at 54-55. A retainer of $125,000.00 was then wired to the firm by Davis from the corporation's money-market account at Merrill Lynch. Id. at 55. The next day, the corporation filed for relief under Chapter 11 of the Bankruptcy Code. Id. Four days later, Davis informed the firm of the filing, and claiming that the retainer was paid from his personal funds, instructed the firm to return the money. Id. The law firm did so. Id.

When the trustee brought an adversary proceeding to recover the money from the firm, the bankruptcy court held that the funds were property of the bankruptcy estate and entered judgment in favor of the trustee. See Boyer v. Davis, et al (In re U.S.A. Diversified Products Inc.), 193 B.R. 868, 882 (Bankr. N.D. Ind. 1995). The district court and the Seventh Circuit affirmed this result. See Carlton, Fields, 100 F.3d at 57; Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. v. Boyer (In re U.S.A. Diversified Products, Inc.), 196 B.R. 801, 815 (N.D. Ind. 1996) The Seventh Circuit concluded that although it was not certain that the funds were property of the estate, the firm possessed enough knowledge of the circumstances to require it to "conduct a reasonable inquiry to determine whose property the $125,000.00 was." See Carlton, Fields, 100 F.3d at 57. The firm's cursory inquiry to Davis was inadequate to protect itself when it also had knowledge that the corporation was bankrupt and of Davis' incentive to recharacterize corporate assets as his own. See id.

Similarly, Vandeventer possessed basic information regarding the debtor's bankruptcy filing. No one

misrepresented information regarding the funds to Vandeventer, making this a stronger case then that of Carlton, Fields. In fact, Vandeventer was contacted on three separate occasions by the Chapter 7 trustee requesting information relating to the profits and inquiring about the male debtor's work in progress on the date of the petition. These letters clearly indicate the trustee's interest in asserting a claim to the funds.

In addition Vandeventer's contention, that a good faith dispute over the fund's inclusion in the estate excuses its distribution, is without merit. In Fitzgerald v. United States (In re Larimer), 27 B.R. 514, 516 (Bankr. Idaho 1983), the court ordered the IRS to pay the debtor's income tax refund to the trustee for determination of the estate's portion and to return the rest to the debtor. Likewise, the profit distributions consisted of property of the estate and the separate post-petition wages of the male debtor. Vandeventer at least had the duty to cooperate with the trustee and inquire into the matter further. The law firm failed to consult with the trustee or make a sufficient inquiry into the relevant facts before distributing the profits in December 1996, and it cannot now avail itself of the exception in §542(c).

Trustee's Breach of Duty

As its second defense, Vandeventer argues that the trustee breached his duty to pursue assets of the estate by failing to make a timely demand for the funds. Vandeventer contends that because the trustee received and read a copy of the law firm's partnership agreement providing for profit distributions in December of each year, the burden shifted to the trustee to intervene and prevent the distributions. Robert L. O'Donnell, a member of the firm's management committee, testified that the committee felt confident in disbursing the profits to the male debtor because the trustee had not responded to the firm's letter dated November 27, 1996. According to O'Donnell, the committee interpreted

the trustee's lack of a response as a decision not to pursue an interest in the profits.

This assumption is not supported by the record. The trustee received the firm's last response on December 2, 1996, two weeks before the first distribution was made. Throughout the fall, responses to each other's correspondence had not been immediate, but had taken several weeks. In addition, the law firm knew that the trustee had never received the information he had requested and needed to use in determining and formulating a good faith claim to a portion of the profits. Vandeventer's assumption was unreasonable in light of the trustee's numerous requests, the law firm's delayed responses and the minimal amount of time between the law firm's last response, on November 27, 1997 and the date of distributions, mid-December.

The plain language of the statute requires that the property be delivered to the trustee. See 11 U.S.C. §542(a). The terms of the section are self-operative and mandatory. Fitzgerald, 27 B.R. at 516. This court agrees with the analysis in Fitzgerald: "[t]here is no requirement in the Code that the trustee make demand, obtain a court order, or take any further action in order to obtain a turnover of the estate's property." Id. Further, the court in Fitzgerald placed the burden on the party holding the property of the estate, rather than the trustee, "to see that the [property] is delivered as required by the statute." See id.

Although the trustee failed to make a specific demand for the funds, his duties under the Code are irrelevant to those imposed on Vandeventer. See Boyer v. Davis, 193 B.R. at 879. Moreover, his correspondence places the law firm on notice of a potential claim by the estate, and he was diligently attempting to gather information necessary to determine the estate's interest in the funds. In contrast to Vandeventer's view, this court concludes that the trustee's performance in administering the debtors' case is satisfactory.

Possession

Finally, Vandeventer argues that a party cannot be ordered to turnover property it does not currently possess. Relevant case law offers some support for this argument. See e.g. McGraw v. Scott (In re Bell & Beckwith), 44 B.R. 659, 660 (Bankr. N.D. Ohio 1984); Bernstein v. Gailey (In re Gailey, Inc.), 119 B.R. 504, 514 (Bankr. W.D. Pa. 1990). However, this requirement has been examined and questioned at length in Boyer v. Davis, et al. (In re U.S.A. Diversified Products, Inc.), 193 B.R. 868, 872-81 (Bankr. N.D. Ind. 1995). There, the court discussed history of the requirements of present possession to support a turnover order under the Bankruptcy Act and noted that lack of possession was not an absolution from liability: "It only meant that the trustee was required to initiate a plenary proceeding in an effort to obtain a money judgment for what the turnover respondent no longer possessed." Id. at 887. Further, the court concluded that the Bankruptcy Code that replaced the Bankruptcy Act expanded the jurisdiction of the bankruptcy courts beyond the possession limitation. Id. at 878. The express language of §542 (a) merely requires that the party have possession of the property "during the case" and allows the trustee to recover "the value of such property." See 11 U.S.C. §542(a); Boyer v. Davis, 193 B.R. at 878.

In addition, the Code added subsection(c) providing an affirmative defense to those who transfer property in good faith and without knowledge of the bankruptcy case. See Boyer v. Davis, 193 B.R. at 879. The court in Boyer v. Davis viewed the exception as a codification of the equitable defenses created in case law under the Bankruptcy Act and determined that: "Section 542(c) serves no purpose if the lack of present possession requires a judgment for the defendant [to a turnover action]." Id at 878. For these reasons, the court held that present possession in not required to support a turnover action and summarized the law as follows:

> [If] a turnover defendant is still in possession of property of the estate, the trustee may recover that property. If the defendant no longer has possession of property of the bankruptcy estate, the court may inquire into the propriety of its disposition and, if appropriate, enter a money judgment in favor of the trustee for the value of such property.

Id. This analysis was affirmed by the District Court in Carlton, Fields, Ward , Emmanuel, Smith & Cutler, P.A. v. Boyer (In re Diversified Products, Inc.), 196 B.R. 801, 810 (N.D. Ind. 1996), and by the Seventh Circuit Court of Appeals in Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A.(In re Diversified Products, Inc.), 100 F. 3d 53, 56 (7th Cir. 1996).

This court agrees with this well reasoned analysis from the Seventh Circuit. The trustee has the right under §542(a) to recover the value of the property, and Vandeventer's lack of present possession cannot be a defense to an action for turnover by the trustee.[1] Vandeventer clearly had possession of the property until December 1996, well after the petition date. Further, Vandeventer was on actual notice of the bankruptcy case and corresponded with the trustee regarding a possible interest of the estate. Several alternative courses of action were available to Vandeventer to protect itself in this process. However, it chose to transfer the property to the debtors, and when "an entity in possession of estate property receives notice of the bankruptcy filing but nonetheless transfers the property to anyone other than the trustee, it does so at its peril." Boyer v. Davis, 193 B.R. at 879.

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[1] Although not mentioned by either counsel, the court has considered the relevant case of Hager v. Gibson, 109 F.3d 201, 210-11 (4th Cir. 1997). However, Hager does not dictate the result in the present case. Although broadly written, the holding is distinguished by the fact that Hager received and disposed of estate property pre-petition, clearly outside §542(a)'s reach. See Hager, 109 F. 3d at 210-11.

Conclusion

Based on the foregoing, judgment is granted in favor of the trustee on all counts, and Vandeventer is ordered to turnover funds in the amounts of $28,844.10 and $52,133.64 to the estate.

So Ordered.

Date: March 24, 1998

/s/

J. Rich Leonard
United States Bankruptcy Judge